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OFFICE OF THE SECRETARIAT

November 29, 1999

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Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre, 1155 21st Street, NW
Washington, DC 20581

RE: Proposal on Position Limit Reduction of the Muni Index (FR Doc 99-29578)

Dear Ms. Webb:

We at Susquehanna Capital Group welcome this opportunity to comment on the above-referenced position limit rule change proposed by the Chicago Board of Trade (CBOT). We wish to note at the onset, however, that it is difficult for us to give our full comments without better knowing the CBOT's reasons and intended effects for this filing. The absence of any stated reasons to support the filing makes it difficult to respond fully. Effected parties cannot comment effectively if they are not given the underlying reasons and intended effects respecting the proposal. Thus, our first recommendation is to have the CBOT articulate its reasons for recommending the change before any portion of the filing is adopted.

While we can only guess as to the reasons behind the 3-day reduction proposal, we can nonetheless give what we think are the inevitable effects of the proposal. First, this proposal is not a technical tweaking of the muni index products, but rather, constitutes a major change in the trading of the products and the underlying instruments. It will essentially drive larger firms from fully competing in muni index contracts at all times during each expiration cycle, and not just the 3-day period. Larger firms[1] will most likely need to impose an effective limit on themselves that will be far below the 4,000 limit. This is because price fluctuations in the component bonds could cause delta changes to muni options, which will in turn cause changes in aggregate delta positions. Also, larger firms may often forego participating in time spread opportunities as the overhanging need to reduce one of the legs prior to expiration will make carrying the other leg infeasible in many instances.

[1] Larger firms, as used herein, refers to those muni futures trading firms that frequently maintain delta positions in the CBOT muni products of amounts greater than the proposed 4,000 contract limit

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In short, the considerable level of liquidity provided by larger firms would be appreciably reduced. The loss in liquidity would be hard felt not just in the futures and options, but also in the municipal securities market. This liquidity loss would not just be a loss to municipal investors, it would also be hard felt by municipal issuers at the state and local levels. The Commission should provide, or ask the CBOT to provide, an economic analysis of the reduction in liquidity expected by this position limit reduction. We ask that such an analysis be performed before any action is taken on the proposal.

Our final point pertains to what we are guessing is the reason for this proposal. That is, the CBOT appears to have a concern that unwinding large futures positions on expiration can lead to unwieldy expiration volatility. But this concern is blind to several important factors. It fails to recognize that expiration periods may be more volatile with the 3-day reduction, since customers unwinding on or near expiration will be forced to do so without the larger hedging firms to provide liquidity in their usual fashion. And the filing appears to presume that the possibility of some volatility on expiration outweighs the benefit of larger firms participating more actively in the market for the entire quarter.[2]

It is clear that customers benefit greatly from the tighter quotes provided by the larger arbitraging and hedging firms. And it is clear that these firms depend on the hedging exemptions that the Exchange has historically provided. Foregoing these benefits for the sake of an expiration concern that has not authoritatively been established would be a mistake.

In conclusion, less liquidity translates into wider quotes. This proposal hurts customers and the municipal market in general. The proposal should be denied and the Exchange should re-think the implications before submitting any modified versions. If it determines to pursue the position limit change notwithstanding further review, it should perform the necessary studies to ensure that its theories are empirically tested.

Once again, thank you for this opportunity to respond.

Sincerely,

Gerald D. O'Connell

Gerald D. O'Connell
Compliance Director

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[2] Instead of changes to the position limit rules and practices, the Exchange should continue its focus on making sure that members abide by the regulations already in place to ensure appropriate expirations. That is, the Exchange already has within its power the ability to make sure that quotes for index bonds at expiration are represented as "firm" bids and offers.